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Basel Committee on Banking Supervision
International Organization of Securities Commissions

Consultation

Margin requirements for non-centrally-cleared derivatives

Non-confidential version

Date: 28 September 2012

Dear Ladies,

Dear Sirs,

We would like to thank you for the opportunity to comment on the consultative document issued by BCBS and IOSCO on Margin requirements for non-centrally-cleared derivatives.

Union Investment is the asset manager of the German cooperative banking network holding more than € 187 bn. assets under management for retail and institutional clients.

Please find our specific comments below.

Yours sincerely

Q 1: What is an appropriate phase-in period for the implementation of margining requirements on non-centrally-cleared derivatives? Can the implementation timeline be set independently from other related regulatory initiatives (eg central clearing mandates) or should they be coordinated? If coordination is desirable, how should this be achieved?

If they do, <u>the phase-in period should be at least five years.</u>

Since UCITS and other regulated investment funds have been regulated on a high degree even prior to the financial markets crisis, some investment management companies respectively UCITS and other regulated investment funds have never been asked by a counterparty for collateralizing OTC Derivatives in the past. This should be considered, when determining an appropriate phase-in period. Furthermore, it needs to be considered that UCITS and regulated investment funds are subject to strict regulations and therefore have to consider much more rules when implementing a collateralization process (e.g. the diversification requirement applicable to collateral[1]).

As far as the question also considers the implementation of any initial margin requirement, we believe that the financial industry requires several years for implementation:

If initial margin shall be segregated from the regular collateralization (cf. Principle 5), such can only take place via the pledge of collateral or by appointing a trustee. The trustee arrangement must be in compliance with the relevant insolvency laws. For that reason, a market standard documentation is required which is audited on a regular basis (yearly) in order to ensure that it is in compliance with the different national insolvency laws. A similar situation would be given with respect to the pledge of security collateral. The pledge is subject to the national law of property. Audits might be required in order to ensure that the pledge is enforceable under the relevant law of property. Furthermore there is legal uncertainty regarding the applicable law of property when the relevant security is certified in a multiple share document.

The mentioned aspects show that it will be very time consuming developing a market standard for the implementation of an initial margin. Furthermore it be will expensive auditing the required legal documents for several countries on a regular basis. Since the default risk arising from OTC Derivatives is already sufficiently mitigated by the risk mitigation techniques set out in EMIR and G20 did not agree on eliminating any and all risks, we generally believe that reg-

[1] Cf. ESMAs Guidelines on ETFs and other UCITS issues, para. 40e.

ulators should not consider any initial margin requirement (especially, as it does not mitigate any risk regarding OTC derivatives, not centrally cleared, cf. our answer to Q13).

Q 2: Should foreign exchange swaps and forwards with a maturity of less than a specified tenor such as one month or one year be exempted from margining requirements due to their risk profile, market infrastructure, or other factors? Are there any other arguments to support an exemption for foreign exchange swaps and forwards?

Yes, an exemption would be supportive.

Until now, the specifics of UCITS and other regulated investment funds have not been considered by the regulators. Especial open-ended real estate funds (being qualified as AIF) might face problems to hedge currency risks in future since they do not have sufficient access to collateral being qualified eligible in the clearing process. The existing liquidity is required for the redemption of fund units.

The settlement risk of foreign exchange swaps and forwards is already mitigated by the usage of the established settlement systems. For the given reasons those OTC Derivatives should be treated like in the US proposal.

Q 3: Are there additional specific product exemptions, or criteria for determining such exemptions, that should be considered? How would such exemptions or criteria be consistent with the overall goal of limiting systemic risk and not providing incentives for regulatory arbitrage?

Yes, a further exemption should apply where ESMA determines a class of derivatives clearing-eligible but the CCP offering clearing does not meet the regulatory criteria, UCITS and other regulated investment funds have to fulfill (e.g. the CCP only offers omnibus segregated accounts). Unfortunately the specifics of UCITS and other regulated investment funds have not been considered in EMIR. According to the provisions of EMIR, ESMA is not able to consider the specifics of UCITS and other regulated investment funds when determining a class of OTC derivatives clearing-eligible. The current approach of the regulators might lead to a factual prohibition for UCITS and other regulated investment funds to use certain standardized OTC Derivatives.

The above would be consistent with the overall goal as it was never intended by G20 to block market participants from using standardized OTC Derivatives.

Q 4: Is the proposed key principle and proposed requirement for scope of applicability appropriate? Does it appropriately balance the policy goals of reducing systemic risk, promoting central clearing, and limiting liquidity impact? Are there any specific adjustments that would more appropriately balance these goals? Does the proposal pose or exacerbate systemic risks? Are there any logistical or operational considerations that would make the proposal problematic or unworkable?

Since G20 did not set a requirement for initial margins, it should be subject to a fair balance considering all advantages and disadvantages whether initial margins shall be implemented by all market participants.

For that reason we appreciate that it is broad consensus within the BSBC and IOSCO that the margin requirements need not to apply to non-centrally-cleared derivatives to non-financial entities that are not systemically important. We share the opinion that prior to any new regulation it should be evaluated if it is required. If there are non-financial entities which are not systemically important and therefore should be out of the scope, we believe that especially UCITS but also certain regulated AIF should be out of the scope for a similar reason, even when being qualified as financial counterparty under EMIR:

UCITS and other regulated investment funds are already subject to a very high degree of regulation. They are only allowed to agree on OTC Derivatives which can be fulfilled with the assets of the investment fund ("cover rule"[2] - how could those Derivatives be subject to higher capital requirements?). Additionally they have to consider counterparty risk limits (10% of the NAV). For these reasons counterparties of UCITS and other regulated investment funds would not face a counterparty risk even if there was no mandatory collateralization of OTC Derivatives. Due to the existing counterparty concentration limits, the risk management processes of the investment funds respectively their manager but also the new obligation to collateralize any OTC Derivative not subject to a clearing obligation (variation margin), there is only a theoretically remaining counterparty risk (regarding a over-collateralization provided to the counterparty in consequence of applying haircuts) to be borne by the investors of UCITS and other regulated investment funds. Typically, the losses which might result in case of the insolvency

[2] see also consultation CESR/10-108

of a counterparty, which we deem minor, are carried by the joint group of investors. We are not sure if such a worst case scenario would mean a loss of more than one Cent per fund unit.

In addition, we believe that with respect to OTC derivatives not centrally cleared, there is no risk at all which can be mitigated through initial margins (cf. our answer to Q13).

The implementation of an initial margin requirement would incur implementation costs as well as ongoing costs (cf. our answer to Q1) .

Putting together all these facts, we have the impression that the disadvantages of statutory initial margin requirements on non-centrally cleared OTC derivatives at least overbalance in so far as UCITS and other regulated investment funds are concerned.

We believe that BSBC and IOSCO should waive any initial margin requirement or at least consider exemptions from it for UCITS and other regulated investment funds, as they aim to do for non-financial entities that are not systemically important.

Such a consideration would also meet the G20's goal to avoid overlapping regulations.[3]

Finally we would like to address that we do not see a liquidity issue being related to a potential initial margin requirement. If cash collateral would be eligible as initial margin, any default risk of the counterparty would be exchanged or topped by default risk regarding the bank maintaining the cash account (cf. our answer to Q22).

Q 5: Are initial margin thresholds an appropriate tool for managing the liquidity impact of the proposed requirements? What level of initial margin threshold(s) would be effective in managing liquidity costs while, at the same time, not resulting in an unacceptable level of systemic risk or inconsistency with central clearing mandates? Is the use of thresholds inconsistent with the underlying goals of the margin requirements? Would the use of thresholds result in a significant amount of regulatory arbitrage or avoidance? If so, are there steps that can be taken to prevent or limit this possibility?

For the reasons provided in our answer to Q1, we believe that costs of implementation as well as ongoing costs will incur as soon as a market participant has to consider initial margin requirements. Therefore we expect that a certain threshold might not reduce the costs signifi-

[3] Cf. G20, Cannes summit final declaration, para. 24 (http://www.g20.org/images/stories/docs/eng/cannes.pdf).

cantly. Therefore it should be evaluated by BSBC and IOSCO if any initial margin requirements are appropriate at all.

Q 6: Is it appropriate for initial margin thresholds to differ across entities that are subject to the requirements? If so, what specific triggers would be used to determine if a smaller or zero threshold should apply to certain parties to a non-centrally-cleared derivative? Would the use of thresholds result in an unlevel playing field among market participants? Should the systemic risk posed by an entity be considered a primary factor? What other factors should also be considered? Can an entity's systemic risk level be meaningfully measured in a transparent fashion? Can systemic risk be measured or proxied by an entity's status in certain regulatory schemes, eg G-SIFIs, or by the level of an entity's non-centrally-cleared derivatives activities? Could data on an entity's derivative activities (eg notional amounts outstanding) be used to effectively determine an entity's systemic risk level?

For the reasons provided under Q4, we believe that due to a lack of systemic risk and the high degree of already existing regulation, UCITS and other regulated investment funds should be excluded from the initial margin requirement, if any.

Q 7: Is it appropriate to limit the use of initial margin thresholds to entities that are prudentially regulated, ie those that are subject to specific regulatory capital requirements and direct supervision? Are there other entities that should be considered together with prudentially-regulated entities? If so, what are they and on what basis should they be considered together with prudentially-regulated entities?

We welcome the approach of BSBC and IOSCO to consider the degree of existing regulation applicable to some market participants. For the reasons provided under Q4, we believe that UCITS and other regulated investment funds are regulated at such a high level, that it would be appropriate to exclude those from any initial margin requirement.

If BSBC and IOSCO do not intend to follow-up with their approach of excluding market participants not meaning a systemic risk, it should be ensured that UCITS and other regulated investment funds at least benefit from being qualified as prudentially-regulated entities.

Q 8: How should thresholds be evaluated and specified? Should thresholds be evaluated relative to the initial margin requirement of an approved internal or third party model or should they be evaluated with respect to simpler and more transparent measures, such as the proposed standardised initial margin amounts? Are there other methods for evaluating thresholds that should be considered? If so what are they and how would they work in practice?

Currently there is no experience with initial margins for non-centrally-cleared derivatives in the market. As far as initial margins are requested by a CCP for centrally-cleared derivatives, there is no dispute on the amounts requested. It would be supportive if there would be precise, easy and transparent rules for the calculation of initial margin amounts, if any. Otherwise we deem it likely that parties to non-centrally-cleared derivatives will be in dispute about the initial margin amounts to be delivered, which would further increase ongoing costs.

Q 9: What are the potential practical effects of requiring universal two-way margin on the capital and liquidity position, or the financial health generally, of market participants, such as key market participants, prudentially-regulated entities and non-prudentially regulated entities? How would universal two-way margining alter current market practices and conventions with respect to collateralising credit exposures arising from OTC derivatives? Are there practical or operational issues with respect to universal two-way margining?

The answer to this question is complex.

Currently especially UCITS are subject to overlapping regulation, even when G20 has agreed to cooperate to avoid loopholes and overlapping regulations.[4] While, according to the provisions of EMIR and the goals of G20, all Financial Counterparties (including UCITS) shall clear all standardized OTC Derivatives via CCPs, ESMA currently hampers UCITS from accessing CCPs. We would like to explain this circumstance briefly:

The clearing process requires cash collateral for fulfilling variation margin calls (this is why also BCBS and IOSCO expect market participants to obtain and deploy additional liquidity

[4] Cf. G20, Cannes summit final declaration, para. 24 (http://www.g20.org/images/stories/docs/eng/cannes.pdf).

resources[5]). Unfortunately, ESMA has published in their Guidelines on ETFs and other UCITS issues that UCITS shall not be allowed anymore to use the purchase price received under a repurchase agreement for providing cash collateral.[6] The terms set out by ESMA also include a prohibition for UCITS to post cash collateral received from a counterparty as own cash collateral contribution to a third party.[7] Since UCITS also have to consider a statutory limitation on credits at 10% of the NAV (and at least a part of those credits are required for the redemption of fund units), it is likely that UCITS will not have access to the volume of liquidity being required in order to agree on standardized OTC derivatives subject to centralized clearing. For that reason it might be consequence that UCITS will be forced to agree on OTC derivatives not subject to any clearing obligation.

Another example for an overlapping regulation are the segregation requirements: UCITS and other regulated investment funds are subject to stricter segregation requirements than those to be considered by CCPs under EMIR.[8] This might lead to the situation that ESMA determines a class of OTC Derivatives clearing-eligible, which is only cleared through a CCP with segregation models which do not meet the segregation requirements of UCITS and other regulated investment funds. Also this circumstance might lead to the situation that UCITS but also other regulated investment funds lose their access to standardized OTC Derivatives.

This increased need of OTC derivatives not subject to any clearing obligation multiplies the potential practical effects of requiring universal two-way (Initial) Margin. Therefore, regulators should either release UCITS and other regulated investment funds from any initial margin requirement or should consider carefully the regulatory specifics of these market participants in order to avoid unintended effects. Especially a limitation of the scope of assets eligible as collateral would be harmful in this regard.

[5] Cf. Page 3 para. 3 of the Consultation paper.
[6] Cf. ESMAs Guidelines on ETFs and other UCITS issues, para. 39/40j.
[7] Cf. ESMAs Guidelines on ETFs and other UCITS issues, para. 40j. The same prohibition is already set-out in national regulations like the German “Derivateverordnung”.
[8] Especially in the constellation where an investment management company manages funds mainly constituted in accordance with contract law (Art. 1 para. 3 of Directive 2009/65/EC): Cf. Art. 8 para. 1 of Directive 2010/43/EC)[8] as well as section 30 (3) of the German Investment Act.

Q 10: What are the potential practical effects of requiring regulated entities (such as securities firms or banks) to post initial margin to unregulated counterparties in a non-centrally-cleared derivative transaction? Does this specific requirement reduce, create, or exacerbate systemic risks? Are there any logistical or operational considerations that would make the proposal problematic or unworkable?

In Germany, UCITS and other regulated investment funds are not allowed to enter into OTC Derivatives with unregulated counterparties. Therefore we do not expect any practical effect in this regard.

Q 11: Are the proposed exemptions from the margin requirements for non-financial entities that are not systemically important, sovereigns, and/or central banks appropriate?

It is pointed-out that G20 did not set a requirement for initial margins. Therefore we appreciate that BSBC and IOSCO considers exemptions from the initial margin requirements where appropriate.

For the reasons already provided under Q4, those exemptions should also apply to UCITS and other regulated investment funds. We believe that this would be in line with the goals of G20.

Q 12: Are there any specific exemptions that would not compromise the goal of reducing systemic risk and promoting central clearing that should be considered? If so, what would be the specific exemptions and why should they be considered?

We believe that UCITS and other regulated investment funds should not be subject to any initial margin requirement. Summarizing the aspects pointed out at our answers above (especially regarding Q4), we would like to justify this as follows:

- UCITS and other regulated investment funds are already subject to a very high degree of regulation;
- Due of the cover rule, UCITS and other regulated investment funds are only allowed to enter into Derivatives which can be fulfilled with the assets belonging to the fund;
- UCITS and other regulated investment funds have to consider counterparty concentration limits and of course are obliged to collateralize as set out in EMIR.

- Even in case of the default of a counterparty, the potential loss (limited by the applicable regulation as well as collateralization), being the remaining risk addressed by any initial margin measures, is to be carried by the joint group of investors. Therefore, we are not sure if such a worst case scenario would mean a loss of more than one Cent per fund unit.
- According to the terms of ESMAs Guidelines on ETFs and other UCITS Issues, UCITS are blocked from using standardized OTC Derivatives in the required volume. If the requirements for initial margin requirement would not be consider the specifics of UCITS (e.g. limitations on eligible assets, liquidity limits), a UCITS might face the situation that it could neither enter into standardized nor bespoke OTC Derivatives required for the management of the retail clients assets. The overlapping regulation regarding segregation might lead to a similar effect.
- UCITS and other regulated investment funds are not systemic relevant.

Q 13: Are the proposed methodologies for calculating initial margin appropriate and practicable? With respect to internal models in particular, are the proposed parameters and prerequisite conditions appropriate? If not, what approach to the calculation of baseline initial margin would be preferable and practicable, and why?

No. On page 16 of the Consultation Paper, BSBC and IOSCO state that "*Initial margin protects the transacting parties from the potential future exposure that could arise from future changes in the mark-to-market value of the contract during the time it takes to close out the position in the event that one or more counterparties default. The amount of initial margin reflects the size of the potential future exposure.*".

The stated reasons for a requirement of initial margins make sense with respect to OTC Derivatives being centrally cleared. With respect to OTC Derivatives not being centrally cleared, we believe that the above understanding leads to the result that no initial margin is required at all:

- Differing from OTC Derivatives being centrally cleared, OTC Derivatives not being centrally cleared are not subject to porting in the meaning of Art. 48 para. 5 EMIR. OTC Derivatives not being cleared are subject to the applicable master agreement between the two parties of the transaction. As set out in the German Master Agreement for Fi-

nancial Derivatives Transactions, in case of the insolvency of one of the parties, all open OTC Derivatives end automatically (automatic early termination) and are closed-out automatically. Therefore, there are no "*potential future exposure that could arise from future changes in the mark-to-market value of the contract during the time it takes to close out the position.*" Other Master Agreements (e.g. the ISDA Master Agreement) include similar provisions.

- As far as the value of collateral posted decreases until or during the realization of collateral following the default of the counterparty, this risk is already hedged by the haircuts applicable to the specific kind of collateral. For that reason, with respect to OTC Derivatives not being centrally cleared initial margins are not required in order to mitigate this kind of risk. For a complete picture we would like to address in this regard that according to para. 42 and 43 of ESMA's Guidelines on ETFs and other UCITS Issues, UCITS shall have in place a clear haircut policy taking into account the characteristics of assets and stress tests.

For the reasons given, we do not see why BSBC's and IOSCO's understanding of the aim of initial margin shall lead to a respective requirement regarding OTC Derivatives not being centrally cleared.

From our perspective a requirement for initial margins would only be given if the applicable Master Agreement does include an automatic early termination provision.

For the reasons given above, any calculation of an initial margin would fail due to a lack of the risk BSBC and IOSCO intent to mitigate.

As far as BSBC and IOSCO intend to avoid an *"undue advantage to non-centrally-cleared derivatives"* (page 20 of the Consultation Paper), we would like to point-out that waiving initial margin requirements for OTC Derivatives not being centrally cleared or at least those subject to a master agreement considering an automatic early termination provision does not mean an *"undue advantage"*.

BCBS and IOSCO have been called to develop for consultation consistent global standards for margin requirements on non-centrally cleared OTC derivatives. In this regard, G20 aims to build a more resilient financial system.[9] It is our understanding that building a more resilient financial system does not make it necessary to apply measures where no risk exists and

[9] G20, Cannes summit final declaration, para. 24 (http://www.g20.org/images/stories/docs/eng/cannes.pdf).

therefore are not to be mitigated. Accepting the fact that no risk exists cannot be deemed undue.

Q 14: Should the model-based initial margin calculations restrict diversification benefits to be operative within broad asset classes and not across such classes as discussed above? If not, what mitigants can be used to effectively deal with the concerns that have been raised?

As stated above, we believe that there is no reason to consider initial margins regarding OTC Derivatives not being centrally cleared (cf. our answer to Q13).

Q 15: With respect to the standardised schedule, are the parameters and methodologies appropriate? Are the initial margin levels prescribed in the proposed standardised schedule appropriately calibrated? Are they appropriately risk sensitive? Are there additional dimensions of risk that could be considered for inclusion in the schedule on a systematic basis?

As stated above, we believe that there is no reason to consider initial margins regarding OTC Derivatives not being centrally cleared (cf. our answer to Q13). Due to a lack of risk, the parameters in the schedule are not appropriate for OTC Derivatives not being centrally cleared.

Q 16: Are the proposed methodologies for calculating variation margin appropriate? If not, what approach to the calculation of baseline variation margin would be preferable, and why?

We do not share BSBC's and IOSCO's opinion that *"minimum transfer amounts (MTAs) should be set sufficiently low so as to ensure that current exposure does not built up before variation margin is exchanged between counterparties."*:

- Every transfer of collateral results in costs. As margining shall protect the parties from potential losses and arising costs are not a potential but a definite loss, we believe that MTAs need to be high enough in order to protect counterparties from inadequate costs;

- We do not share the assumption of BCBS and IOSCO regarding disputes (cf. pages 19 and 20 of the Consultation Paper). Standardized master agreements like for example the German Master Agreement for Financial Derivatives Transactions include rigorous and robust dispute resolution provisions. Especially, it is set out in this regard that the undisputed amount is to be collateralized immediately. Furthermore there is a tight timeframe for solving the dispute. Therefore even disputes regarding high complex OTC Derivatives no not lead to an increased default risk.

We believe that a MTA of EUR 500.000 would be appropriate considering the above. If a Financial Counterparty would not be able to survive a maximum potential loss of EUR 500.000, it should not enter into OTC Derivatives respectively being approved for those kind of transactions.

Q 17: With what frequency should variation margin payments be required? Is it acceptable or desirable to allow for less frequent posting of variation margin, subject to a corresponding increase in the assumed close out horizon that is used for the purposes of calculating initial margin?

It should be calculated on a daily basis if the counterparty exposure from OTC Derivatives reaches the MTA and therefore requires the transfer of Variation Margin.

As stated above, we believe that there is no reason to consider initial margins regarding OTC Derivatives not being centrally cleared (cf. our answer to Q13).

Q 18: Is the proposed framework for variation margin appropriately calibrated to prevent unintended procyclical effects in conditions of market stress? Are discrete calls for additional initial margin due to "cliff-edge" triggers sufficiently discouraged?

No answer.

Q 19: What level of minimum transfer amount effectively mitigates operational risk and burden while not allowing for a significant build-up of uncollateralised exposure?

EUR 500.000,- (please see our answer provided under Q16).

Q 20: Is the scope of proposed eligible collateral appropriate? If not, what alternative approach to eligible collateral would be preferable, and why?

We welcome the BSBC's and IOSCO's decision for the second approach.

UCITS and other regulated investment funds are not allowed to acquire all and any kind of assets (statutory and contractual limitations) and furthermore have very limited access to cash collateral (cf. our answer to Q9). It has been our experience after the default of Lehman Brothers that equities were realized much faster than bonds. Also for that reason, we highly appreciate that equities included in major stock indices are being considered now as eligible collateral.

From our point of view, the list of assets being eligible collateral should also include guarantees issued by a bank (in the meaning of Art. 46 para. 1 EMIR). Otherwise, open-ended real estate funds (being qualified as AIF) might have problems providing eligible collateral.

Furthermore, it should be allowed using corporate bonds with a rating of BBB+, considering a higher haircut.

BSBC and IOSCO should also consider that the financial crisis has shown that the assets currently being deemed highly liquid and of highest quality might lose these characteristics in other market scenarios.

Q 21: Should concrete diversification requirements, such as concentration limits, be included as a condition of collateral eligibility? If so, what types of specific requirements would be effective? Are the standardised haircuts prescribed in the proposed standardised haircut schedule sufficiently conservative? Are they appropriately risk sensitive? Are they appropriate in light of their potential liquidity impact? Are there additional assets that should be considered in the schedule of standardised haircuts?

UCITS and other regulated investment funds already have to consider diversification requirements regarding collateral received (cf. ESMA Guidelines on ETFs and other UCITS Issues,

para. 40 as well as § 22 para. 5 of the German Derivateverordnung). Furthermore they have to avoid a correlation between the collateral an the creditability of the counterparty.

We believe that the table of standardized haircuts would be ok, if it is understood as a guidance level and adjustments at +/- 50% would be allowed. In this regard we refer once again to the ESMA Guidelines on ETFs and other UCITS Issues applicable to UCITS. According to para. 43 of these Guidelines, UCITS are obliged to adjust haircuts if required. Any regulation considering fix haircuts would be in conflict with ESMA Guidelines on ETFs and other UCITS Issues.

Q 22: Are the proposed requirements with respect to the treatment of provided margin appropriate? If not, what alternative approach would be preferable, and why? Should the margin requirements provide greater specificity with respect to how margin must be protected? Is the proposed key principle and proposed requirement adequate to protect and preserve the utility of margin as a loss mitigants in all cases?

No. UCITS and other regulated investment funds are already to a high extent subject to the proposed requirements:

According to para. 40 i) of ESMAs Guidelines on ETFs and other UCITS Issues, non-cash collateral received should not be sold, re-invested or pledged.

According to para. 40 j) of ESMAs Guidelines on ETFs and other UCITS Issues, cash collateral received should only be

- Placed on deposit with entities prescribed in Art. 50(f) of the UCITS Directive;
- Invested in high-quality government bonds;
- Used for the purpose of reverse repo transactions provided the transactions are with credit institutions subject to prudential supervision and the UCITS is able to recall at any time the full amount of cash on accrued basis;
- invested in short-term money market funds as defined in the Guidelines on an Common Definition of European Money Market Funds.

Similar rules are included in the German Derivateverordnung, also applicable to regulated investment funds not being qualified as UCITS (cf. § 22 para. 6).

BSBC and IOSCO generally should allow a re-hypothecation in the aforementioned manner. It is to be paid interest on cash collateral received.

With regard to initial margin requirements, cash collateral should not be eligible collateral. Otherwise the credit exposure to one credit institution (being counterparty) would only be replaced by the credit exposure of the bank keeping the cash account. As credit institutions with a worse credit rating pay higher interests, allowing cash collateral while prohibiting any re-hypothecation might set an incentive for maintaining the cash collateral account with a credit institution not being rated well.

With respect to the key principle that *"collected margin must be subject to arrangements that fully protect the posting party in the event that the collecting party enters bankruptcy to the extent possible under applicable law"* we believe that BSBC and IOSCO should work out how such could be implemented at all:

Such can only take place via the pledge of collateral or by appointing a trustee.

The trustee arrangement must be in compliance with the relevant insolvency laws. For that reason, a market standard documentation is required which is audited on a regular basis (yearly) in order to ensure that it is in compliance with the different national insolvency laws.

A similar situation would be given with respect to the pledge of security collateral. The pledge is subject to the national law of property. Audits might be required in order to ensure that the pledge is enforceable under the relevant law of property. Furthermore there is legal uncertainty regarding the applicable law of property when the relevant security is certified in a multiple share document.

The mentioned aspects show that it will be very time consuming developing a market standard for the implementation of an initial margin regime following the key principle suggested by BSBC and IOSCO.

Q 23: Is the requirement that initial margin be exchanged on a gross, rather than net basis, appropriate? Would the requirement result in large amounts of initial margin being held by a potentially small number of custodian banks and thus creating concentration risk?

As stated above, we believe that there is no reason to consider initial margins regarding OTC Derivatives not being centrally cleared (cf. our answer to Q13).

If BSBC and IOSCO would only determine securities collateral being eligible for initial margins, no concentration risk would to be feared (cf. our answer to Q22).

Q 24: Should collateral be allowed to be re-hypothecated or re-used by the collecting party? Are there circumstances and conditions, such as requiring the pledgee to segregate the re-hypothecated assets from its proprietary assets and treating the assets as customer assets, and/or ensuring that the insolvency regime provides the pledger with a first priority claim on the assets that are re-hypothecated in the event of a pledgee's bankruptcy, under which re-hypothecation could be permitted without in any way compromising the full integrity and purpose of the key principle? What would be the systemic risk consequences of allowing re-hypothecation or re-use?

It depends, please see our answer to Q 22.

Q 25: Are the proposed requirements with respect to the treatment of non-centrally-cleared derivatives between affiliated entities appropriate? If not, what alternative approach would be preferable, and why? Would giving local supervisors discretion in determining the initial margin requirements for non-centrally-cleared derivatives between affiliated entities result in international inconsistencies that would lead to regulatory arbitrage and unlevel playing field?

We do not think that the proposed requirements with respect to the treatment of non-centrally-cleared derivatives between affiliated entities are appropriate.

If companies of the same group, which are fully consolidated and members of the same protection scheme, enter into OTC-derivative transactions any losses resulting for one of the two counterparties do not have any negative impact on the stability of the financial markets.

We believe that, in compliance with the provisions of EMIR, non-centrally-cleared derivatives between affiliated entities should not be subject to any collateralization requirement.

As far as it is intended to give discretion in determining the initial margin requirements for non-centrally-cleared derivatives between affiliated entities to the local supervisory authorities, we believe that this would result in regulatory arbitrage and an unlevel playing field.

Q 26: Should an exchange of variation margin between affiliates within the same national jurisdiction be required? What would be the risk, or other, implications of not requiring such an exchange? Are there any additional benefits or costs to not requiring an exchange of variation margin among affiliates within the same national jurisdiction?

No. We do not see any benefits from such an approach. If companies of the same group, which are fully consolidated and members of the same protection scheme, enter into OTC-derivative transactions any losses resulting for one of the two counterparties do not have any negative impact on the stability of the financial markets.

Q 27: Is the proposed approach with respect to the interaction of national regimes in cross-border transactions appropriate? If not, what alternative approach would be preferable, and why?

We do not share BSBC's and IOSCO's opinion that collateral requirements in the jurisdiction of a company shall apply to foreign subsidiaries. We believe that the relevant national laws and regulations shall apply. Otherwise a fragmentation of applicable rules would take place within the same country, which might lead to a distortion of competition and of course would lead to uncertainty regarding the responsible supervisory authority.